by subsidiaries of the bank holding company.

(5) *Proportionate and undivided interest.* The stock purchased must represent an equitable, equal, and proportionate undivided interest in the underlying assets of the investment company.

(6) *Stockholders shielded from liability.* The stockholders must be shielded from personal liability for acts and obligations of the investment company.

(7) *Bank investment policy and procedures.* (i) The investment policy of the bank, as formally approved by its board of directors, must specifically provide for investment in investment company stock. The investment policy must establish procedures, standards, and controls that relate specifically to investments in investment company stock.

(ii) Prior approval of the board of directors of the bank must be obtained for investment in a specific investment company and recorded in the official board minutes.

(iii) Unless the investment objectives of the investment companies, as stated in their current prospectuses, restrict investments to those obligations that the state member bank could purchase without restriction as to amount, the bank must review its holdings of investment company stock at least quarterly to ensure that investments have been made in accordance with established bank policies and legal requirements.

(8) *Reporting and accounting.* Reporting of holdings of investment company stock must be consistent with established standards for ''marketable equity securities.'' Accordingly, the instructions for the quarterly Reports of Condition and Income and the requirements of the Financial Accounting Standards Board Statement No. 12 must be followed.

(i) Holdings of investment campany stock must be reported as ''All other'' securities on Schedule RC–B, Item 4(b) on the quarterly Reports of Condition, unless otherwise directed.

(ii) In no case may the carrying value of investment stock be increased above aggregate cost as a result of net unrealized gains. Holdings of investment company stock must be reported in the Reports of Condition at the lower of their aggregate cost or aggregate market value, determined as of the report date.

(iii) Sales fees, both ''front end load'' and ''deferred contingency,'' must be deducted in calculating market value.

(iv) Any net unrealized loss or increase in a previously recorded net unrealized loss must be charged directly against ''undivided profits and capital reserves.'' Subsequent reductions of any net unrealized loss must be credited directly to ''undivided profits and capital reserves.''

(v) A loss on an individual investment that is other than temporary, as that term is used for purposes of FASB Statement No. 12, must be charged to ''noninterest expense'' on Schedule RI of the Income Statement.

(d) *Evaluation of investment risk.* Investments in stock of investment companies and direct investments in debt securities are not treated the same for accounting, tax, and other purposes. Consequently, state member banks should evaluate investments in investment company stock in light of these differences and give special attention to the risks these differences impose.[1]

(e) *No effect on state law.* This interpretation shall not be construed as exempting a state member bank from any provision of state law.

[54 FR 7181 Feb 17, 1989; 54 FR 10482, Mar. 13, 1989]

§ 208.125 Necessity for Board approval of stock dividend by State member bank.

(a) The opinion of the Board of Governors has been requested as to whether section 5199(b) of the Revised Statutes of the United States, as amended September 8, 1959 (12 U.S.C. 60), requires the Board's approval for the declaration of a stock dividend by a State member bank in an amount which would exceed the total of net profits

[1] The Board has issued a cautionary letter in conjunction with this interpretation. This letter recommends that a state member bank avoid undue concentration of investments in the stock of any fund or family of funds and apprises state member banks of the accounting and tax treatment of holding investment company stock. *See* Fed. Res. Reg. Svc. ¶3–416.16.

for the present year combined with the retained net profits of the preceding 2 years. This statute is made applicable to State member banks by the sixth paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 324).

(b) The purpose of this provision is to prevent the depletion of the capital structure of a bank by the payment of excessive dividends. Since a stock dividend does not result in the distribution of cash or assets, the Board does not consider the term *dividend* in this statute as including stock dividends. Consequently, the Board's approval for the declaration of a stock dividend is not required.

(12 U.S.C. 60)

[33 FR 9866, July 10, 1968. Redesignated at 55 FR 52987, Dec. 26, 1990]

§ 208.126 Payment of dividends; effect of net losses.

(a) Section 5199(b) of the Revised Statutes (12 U.S.C. 60), as amended in 1959: *Provides*, That:

> The approval of the Comptroller of the Currency shall be required if the total of all dividends declared by [a national bank] in any calendar year shall exceed the total of its net profits of that year combined with its retained net profits of the preceding 2 years * * *

Under the sixth paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 324), member State banks are required ''to conform to the provisions of section 5199(b) * * * with respect to the payment of dividends'', except that the approval of the Board of Governors is required in lieu of the approval of the Comptroller.

(b) The question has arisen whether it is necessary in determining whether a bank's dividends in a particular year ''exceed the total of its net profits of that year combined with its retained net profits of the preceding two years'', to take into consideration the amount of a net loss in the current year or in one or both of the preceding 2 years.

(c) The purpose of the 1959 amendment of section 5199(b) was to prevent a bank from paying a dividend (except with supervisory approval) unless it has on hand, from operations during the 3 latest years, sufficient net profits to cover the proposed dividend. If a net loss for one or more of those 3 years was disregarded in making the calculation called for by section 5199(b), a member State bank could pay dividends, without the approval of the Board of Governors, even though the aggregate results of the 3 latest years' operations was a net deficit. This was precisely the sort of situation in which Congress intended to prevent the payment of a dividend unless the supervisory authority was satisfied that special circumstances justified the proposed dividend.

(d) Accordingly, it is the position of the Board that, in making the calculation required by section 5199(b), it is necessary to take into consideration the actual results of operations during the current year and the 2 preceding years, whether the figures for those years are plus or minus figures. For example, if a bank had

(1) Retained net profits of $30,000 from 1959;

(2) A net loss of $40,000 in 1960 (and dividends of $10,000 were paid in that year, with the Board's approval); and

(3) Net profits of $20,000 in 1961,

It could not pay any dividend in 1961 without the Board's approval, since the calculation required by section 5199(b) would result in a zero figure ($30,000 minus $50,000 plus $20,000). It will be noted that, for the purposes of section 5199, any dividends paid in a loss year must be included in the ''net loss'' for that year, just as dividends paid in a profitable year must be deducted from ''net profits'' in calculating ''retained net profits''.

(12 U.S.C. 60)

[33 FR 9866, July 10, 1968. Redesignated at 55 FR 52987, Dec. 26, 1990]

§ 208.127 Payment of dividends exceeding net profits to date of declaration.

(a) Section 5199(b) of the Revised Statutes of the United States (12 U.S.C. 60) and the sixth paragraph of section 9 of the Federal Reserve Act (12 U.S.C. 324), provide in effect that ''the approval of the Comptroller of the Currency (or the Board of Governors) shall be required if the total of all dividends declared by such association (a national bank or a member State bank) in any calendar year shall exceed the